IN THE SUPREME COURT

APPEAL FROM THE COURT OF APPEALS

Murphy C.J., Fitzgerald, Borrello, J.J.

DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,
STATE OF MICHIGAN,

Defendant-Appellant.

Supreme Court No. 148753

Court of Appeals No. 309732

Court of Claims No. 10-104-MT

BRIEF ON APPEAL OF PLAINTIFF-APPELLEE

ORAL ARGUMENT REQUESTED

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STATEMENT OF BASIS OF JURISDICTION

Plaintiff-Appellee, Detroit Edison Company ("DTE"), agrees with Defendant-Appellant's, Department of Treasury, State of Michigan (the "Department") Statement of Basis of Jurisdiction.

COUNTER-STATEMENT OF QUESTION PRESENTED

1. Whether equipment used within the unified electric system to generate, process, condition, control and monitor electricity until the electricity has reached the required regulatory parameters to be safely provided to customers in its final form at the customer's meter qualifies for the industrial processing exemption from use tax under MCL 205.94*o*?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   Court of Claims answered, "Yes."

   Court of Appeals answered, "Yes."

2. Whether equipment that performs industrial processing activities 100% of the time is entitled to a 100% apportioned exemption from use tax under MCL 205.94*o*(2), even as the unfinished product is simultaneously being moved through the unified electric system?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   Court of Claims answered, "Yes."

   Court of Appeals answered, "Yes."

I. INTRODUCTION

The issue before this Court is the application of the statutory use tax industrial processing exemption, as amended by 1999 PA 117, for equipment outside DTE's generation plant that is used in providing electricity to its customers. Qualification for the industrial processing exemption is dependent upon the activities performed by the equipment, not the location. *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144; 549 NW 2d 837 (1996). Under the amended statute, industrial processing is not complete until there is a finished good. The question before this Court is whether equipment used by DTE, an acknowledged industrial processor, is exempt under the industrial processing exemption based upon the uncontroverted testimony in this case that electricity is not, and cannot be, a finished good until it passes through the customer's meter. Prior to this point, electricity is a dangerous product, unusable by the customer, regulated to prevent injury and even death to those who may be exposed to it while it is continuously processed, converted, conditioned, controlled, supervised, inspected, tested and monitored to ensure adherence with federal and state regulations.

Under the plain language of the statute, DTE's equipment qualifies as exempt under the controlling statutory definition of industrial processing and four subsections that expand and enlarge this definition to include the specific activities performed by the equipment at issue. The Department's argument that a generic carve-out for shipping activities disqualifies the equipment is incorrect because: (1) in-process distribution activities are statutorily exempt; (2) the rules of statutory construction require reconciliation of conflicting subsections to apply the shipping carve-out only to activities that occur after the production of a finished good; (3) the equipment performs processing, not shipping activities; and (4) industrial processing activities that occur

concurrently with any distribution activities are exempt under the statute and precedential case law.

Although not argued below and, therefore, waived by the Department, under the industrial processing apportionment provision, MCL 205.94*o*(2), DTE is entitled to a 100% exemption, which does not require Department preapproval, as the equipment is unceasingly performing industrial processing activities, even if nonexempt activities also occur. The rules cited by the Department to prohibit the application of the exemption pre-date the amended statute, do not reflect the statutory definition of "industrial processing" and conflict with the statute as amended. These rules are invalid and inapplicable.

Electricity providers engaged in electric system operations are the sole users of the equipment in this case. The Department's claim of a judicial "rewrite" of existing statutes to benefit this group is incorrect. This is not a matter of unjust enrichment to a particular company or industry, it is the appropriate conclusion reached by both the plain language of the statutory exemption and by statutory interpretation, the benefit of which flows through this regulated industry to the citizens of Michigan. This Court should affirm that DTE's equipment qualifies for the industrial processing exemption, that DTE is permitted a 100% exemption, and that the rules cited by the Department are invalid as they conflict with the industrial processing exemption statute.

II. LEGAL STANDARDS

A. Counter-Statement of Standard of Review.

The Court of Appeals' holding that DTE was entitled to a 100% industrial processing exemption for equipment performing industrial processing activities in providing electricity is a question of statutory construction that this Court reviews *de novo*. *Danse Corp v Madison Hts*,

466 Mich 175, 178; 644 NW2d 721 (2002) ("Issues concerning the interpretation and application of statutes are questions of law that this Court decides *de novo*.")

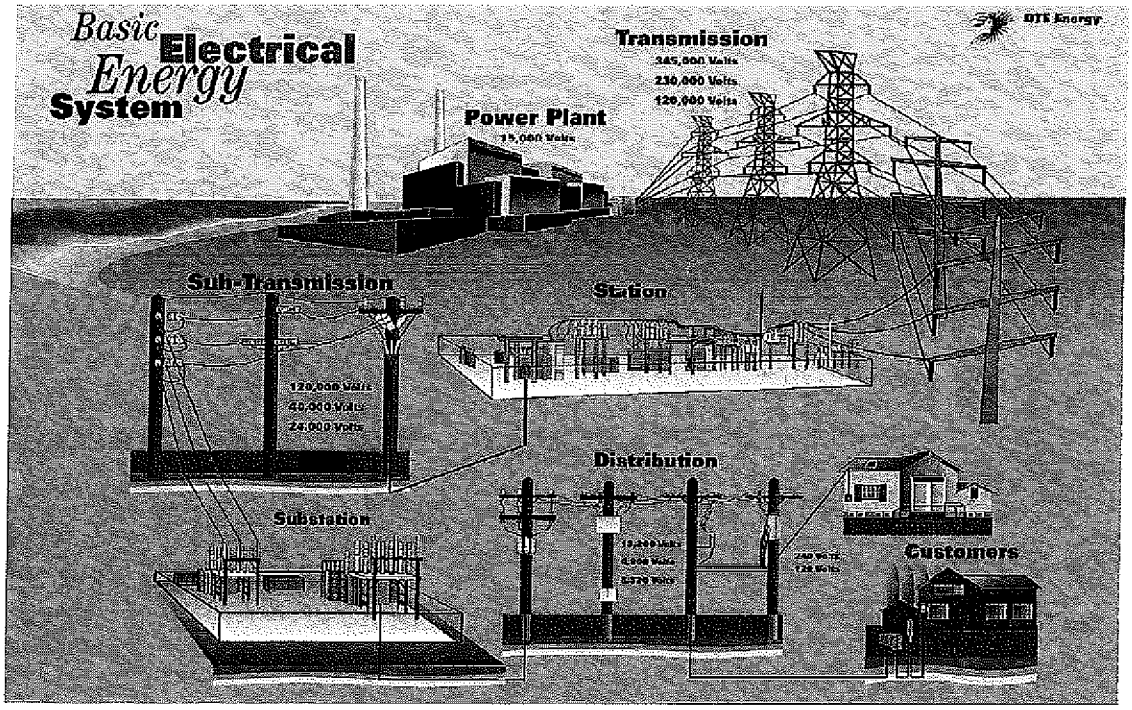
B. Construction of Tax Statutes.

When tax statutes are construed, any ambiguities are resolved in favor of the taxpayer. *Michigan Bell Telephone Co v Mich Dep't of Treasury*, 445 Mich 470, 477; 518 NW2d 808 (1994). The taxpayer has the burden of proving entitlement to an exemption. *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144, 150; 549 NW2d 837 (1996). While a taxpayer has the burden of proof to show that it is entitled to a tax exemption, a tax exemption should not be contracted or expanded by construing it according to implication or a forced construction. *Michigan Allied Dairy Ass'n v Auditor General*, 302 Mich 643, 650; 5 NW2d 516 (1942) (discussing the agricultural and industrial processing exemptions).

III. COUNTER-STATEMENT OF FACTS AND PROCEDURAL BACKGROUND

A. Overview of the DTE Electric System.

The nature of DTE's manufacturing operations cannot simply be described as the "sale" of electricity. DTE is an integrated utility company generating, transmitting, processing and furnishing electricity to approximately 2.1 million residential, commercial and industrial customers in Southeast Michigan. DTE's activities are regulated by numerous federal and state governmental agencies, with the primary state agency being the Michigan Public Service Commission ("MPSC"). Brown Aff ¶13, App 223a. As electricity operations are essential to the maintenance of our society, as well as inherently dangerous, strict standards must be followed to provide a safe, reliable, high-quality product.



The production of electricity requires an integrated, interrelated and interconnected system that includes generation plants, substations, transmission lines, distribution systems, transformers and meters spread out over a large geographic area (hereinafter "Electric System").[1] Phillips Aff ¶¶14-15, App 204a-205a; and Attachment A to Phillips Aff, App 219a-220a; Professor Fuchs Aff ¶24, App 235a; Professor Wollenberg Aff ¶¶17, 24, App 251a-252a.

The equipment at issue, which is used throughout the Electric System, can be broken down into three broad categories: (1) Voltage Processing Equipment[2], (2) Power Quality Control

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[1] The MPSC adopts this concept of a single system and defines "electric plant" as "all real estate, fixtures or property that is owned, controlled, operated or managed in connection with or to facilitate the production, transmission and delivery of electric energy." Mich Admin Code, R 460.3102(e).

[2] Voltage Processing Equipment adjusts the voltage, frequency and other characteristics of electricity and includes the equipment located at a substation, as well as transformers, regulators, capacitors and supply batteries located throughout the system. Phillips Aff ¶¶ 128, 129, App 216a.

Equipment[3], and (3) Safety and Power Monitoring Equipment.[4] See Attachment C to Phillips Aff, App 46b-54b for a detailed list of the equipment contained in each category. The equipment is much more than the mere "poles, wires, cables, and containers" referenced by the Department. Appellant's Brief at 5. The Voltage Processing Equipment, Power Quality Control Equipment and Safety and Power Monitoring Equipment within the generation plant have been recognized as exempt processing equipment. Thus, only equipment outside the generation plant is at issue in this case. Through this equipment, the same industrial processing activities that occur within the generation plant must continue to occur throughout the Electric System, until the electricity reaches the customer's meter. Professor Fuchs Aff ¶24, App 235a.

The voltage level of the electricity at the generator ranges from 15,000 to 25,000 volts. Phillips Aff ¶72, App 210a. This voltage is too high for DTE's customers to use. Professor Fuchs Aff ¶25, App 235a; Professor Wollenberg Aff ¶22, App 251a; Phillips Aff ¶76, App 211a. The vast majority of DTE's customers use electricity at the 120/240 volt level—for them, this is the "finished product." Professor Fuchs Aff ¶34, App 237a; Phillips Aff ¶57, App 210a. Thus, the electric power exiting a generation plant is only partially "manufactured" and cannot legally be sold at retail because homes, businesses and factories are not able to use the voltage levels that are produced at the terminals of a generator. Professor Fuchs Aff ¶34, App 237a; Professor Wollenberg Aff ¶22, App 251a; Phillips Aff ¶80, App 211a; Cook Dep 77:8-14, App 172a.

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[3] Power Quality Control Equipment controls the quality of the electricity, controls the production of electricity, and includes system control and data acquisition ("SCADA") computer equipment, breakers, reclosers and capacitors. Phillips Aff ¶¶128-131, App 216a;138-140, App 217a.

[4] Safety and Power Monitoring Equipment monitors and tests the electricity to ensure that it meets the required MPSC parameters and includes temperature gauges, relays, and control meters. Phillips Aff ¶¶134, 135, App 217a. Each category of equipment also includes additional ancillary equipment used to support and maintain the equipment performing the industrial processing activity. This ancillary equipment is specifically defined as exempt industrial processing equipment under MCL 205.94*o*(4)(b).

The laws of physics do not permit electricity to be commercially produced at the 120/240 volt level. Professor Fuchs Aff ¶32, App 236a; Phillips Aff ¶74, App 211a; Cook Dep 103:2-4, App 179a.[5] From the generation plant, the electricity's voltage must be stepped up and then stepped down with the use of transformers and other Voltage Processing, Power Quality Control, and Safety and Monitoring equipment to make it safe, reliable and usable by DTE's customers and comply with MPSC and federal regulations. Phillips Aff ¶¶78, 79, App 211a; Brown Aff ¶68, App 230a; Professor Wollenberg Aff ¶27, App 252a; Professor Fuchs Aff ¶¶35-36, App 237a.

Through the use of Voltage Processing Equipment, Power Quality Control Equipment, and Safety and Power Monitoring Equipment in the Electric System, the electricity continues to be processed, converted, conditioned, controlled, supervised, inspected, tested and monitored as it moves through the Electric System to reach its final form that is usable to customers. Phillips Aff ¶¶88-90, App 212a.[6]

B. The Department's Audit.

The Department conducted audits of DTE for the tax period beginning January 1, 2003 through September 30, 2006 (the "years in issue"). The Department allowed the industrial processing exemption from use tax for certain equipment purchased by DTE for use in its Electric System, but denied the industrial processing exemption for other processing, monitoring

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[5] Appellee erroneously portrayed that Thomas Edison produced electricity at the 120/240 volt level. A review of the authority cited by Appellee, reveals that the production of electricity at this voltage level only permitted Edison to provide electricity for two miles, which was not commercially viable. To provide electricity today at the 120/240 volt level would require a wire with a circumference of 46 times what is currently available. Phillips Aff ¶74, App 211a.

[6] Due to the inherently dangerous nature of electricity, failure to adhere to Regulatory Standards can result in damage to appliances and equipment, destruction of homes and businesses, risk of fire and electrocution, and even death to DTE customers and employees. Professor Wollenberg Aff ¶20, App 251a; Professor Fuchs Aff ¶31, App 236a; Phillips Aff ¶¶60-62, App 210a; Brown Aff ¶¶39-41, App 226a-227a; Cook Dep 99:25 to 100:10, App 178a.

and testing equipment based solely on the equipment's location outside the generation plant. Tomlinson Aff ¶¶13, 20, App 57b, 58b. The Department's auditor stated that the sole reason the Department denied an exemption for certain equipment was because this equipment was not located at a generation plant, even though the equipment is used in an identical manner and performed the same activities as equipment which the auditor found to qualify for the industrial processing exemption at a generation plant.[7] Deposition of Yolanda Stokes 9:20 to 10:10, App 333b-334b. Public electric utilities within the Federal Energy Regulatory Commission jurisdiction are required to maintain their books and records in accordance with the Commission's Uniform System of Accounts ("USofA"). The USofA provides basic account descriptions, instructions and accounting definitions that are useful in understanding the information reported in annual reports prepared by utilities.[8] DTE's Department Account Codes titled "Transmission" and "Distribution" are the accounting nomenclature commonly used by electric utilities, and these accounting codes do not describe the nature of DTE's activities.[9]

C. Court of Claims Proceedings.

The Court of Claims below issued an Opinion and Order holding that the equipment used by DTE in its electric operations prior to the electricity reaching its usable finished form at the customer's meter clearly qualified for the statutorily enacted industrial processing exemption. Opinion and Order issued March 28, 2012 ("COC Opinion"), at 11-12. App 53a-54a. The court found that electricity production does not cease until the electricity reaches the customer's meter,

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[7] The Department allowed the exemption for identical equipment, such as transformers or capacitors, if coded in DTE's general ledger in the "Generation" Department Account Code but denied it if coded otherwise. Tomlinson Aff ¶39, App 60b.

[8] See 18 CFR 101 available at Electronic Code of Federal Regulations, http://ecfr.gpoaccess.gov/cgi. (accessed December, 2014).

[9] Wheeler Aff. ¶¶9, 10, App 72b-73b.

and, the equipment was entitled to the industrial processing exemption. COC Opinion at 10, App 52a. The court ruled that under the *undisputed facts*, it is evident that electricity continues to be processed by the equipment up until the point where it reaches the customer's meter, thereby clearly and unambiguously qualifying for the statutorily available industrial processing exemption from use tax per MCL 205.94*o*. *Id.* at 8, App 50a. The court noted that the Department failed to contradict the evidence presented by DTE as to the amount of the exemption claimed, the equipment at issue, the function of the equipment within the Electric System or when the electricity is a final product available for use by its customers in a safe and nonhazardous manner, as mandated by state and federal regulatory requirements. *Id.* at 10, App 52a.

D. Court of Appeals Proceedings.

The Court of Appeals affirmed the Court of Claims holding that the Department unlawfully imposed use tax on the equipment used in industrial processing activities in the Electric System. *Detroit Edison Co v Dep't of Treasury*, 303 Mich App 612; 844 NW2d 198 (2014). App 1b-13b. The Court of Appeals observed that "as opposed to the extremely detailed scientific views espoused by DTE's experts, which explain and elaborate on the physics involved and why the electricity continues to be 'processed,' the one expert relied on by the Department submitted an affidavit that is essentially conclusory in form, cursorily stating that the composition, nature and character of electricity does not change during transmission and distribution." *Id.* at 627-628, App 10b.[10] The Court of Appeals noted that the Department did not cite any documentary evidence that counters the positions of DTE's experts as to the exempt

[10] Citing *Hamade v Sunoco, Inc. (R&M)*, 271 Mich App 145, 163; 721 NW2d 233 (2006) ("[M]ere conclusory allegations within an affidavit that are devoid of detail are insufficient to create a question of fact.")

nature of the industrial processing activities performed by the equipment used to produce, inspect, test and control the quality of electricity as it flows through the transmission and distribution system. *Id.* at 626-627, App 9b-10b. The Court of Appeals reiterated that "electricity is not a finished good until it reaches the meters of DTE's customers." *Id.* at 629, App 11b and noted:

> [T]hat because "electricity" was and is expressly included in the definition of "tangible personal property," MCL 205.92(*l*), as amended by 2000 PA 391, effective January 3, 2001; MCL 205.92(k), as amended by 2004 PA 172, effective September 1, 2004, and because it is "tangible personal property" that must be converted or conditioned, MCL 205.94*o*(7)(a), it could be argued that it was envisioned that "electricity" might be subject to ongoing and continuing industrial processing. [*Id.* at 629, fn 7, App ___b.]

The Court of Appeals dismissed the Department's allegation that MCL 205.94*o*(6)(b), the generic "distribution-activity" exclusion, would deny DTE's exemption. The Court of Appeals concluded that the industrial processing exemption and the distribution-activity exclusion must be read in *pari materia* when equipment is used concurrently to provide an exempt activity and a nonexempt activity. *Id.* at 629-630, App 11b. The Court of Appeals found "caselaw is clear that the 'industrial processing' exemption applies to the machinery and equipment *in full*." (Emphasis supplied). *Id* at 630, App 11b. The Court of Appeals found that "'[C]oncurrent taxable use with an exempt use does not remove the protection of the exemption'", quoting *Mich Milk Producers Ass'n v Dep't of Treasury*, 242 Mich App 486, 495; 618 NW2d 917 (2000). *Id.* at 631, App 12b. Indeed, the Court of Appeals concluded:

> DTE is entitled to the claimed industrial processing exemption in full, despite the fact that the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e., distribution, given that the machinery and equipment are concurrently being used to also industrially process electricity, all as part of a unified process or system. [*Id.* at 631-632, App 12b].

The Court of Appeals found Rule 205.115(4) ("Rule 65") which the Department argued required the equipment to be taxable, was invalid, as it conflicted with the governing statute, and thus was unenforceable. *Detroit Edison,* 303 Mich App at 632, fn 11, (citing *Guardian Indus Corp v Department of Treasury*, 243 Mich App 244, 254; 621 NW2d 450 (2000)), App. 12b.

The Department filed a Motion for Reconsideration, which the Court of Appeals denied. App 15a. Subsequently, this Court granted the Department's Application for Leave to Appeal. See October 1, 2014 Order of the Supreme Court granting Defendant/Appellant's Application for Leave to Appeal.

IV. ARGUMENT

A. The Equipment Used in DTE's Industrial Processing of Electricity Throughout its Electric System Qualifies for the Industrial Processing Exemption.

1. DTE is an Industrial Processor.

All parties agree that DTE is an industrial processor and that electricity production is an industrial process. COC Opinion at 5, App 47a. The production of electricity has been recognized as an industrial process by the judicial system for more than 50 years. *Builders Steel Supply Co and Consumers Power Co v Dep't of Revenue*, Michigan State Board of Tax Appeals Docket No. 285, p 3 (December 15, 1955) ("It is an admitted fact that the production of electric energy constitutes 'industrial processing.'")

2. The Application of the Expanded Industrial Processing Exemption to All the Equipment Used to Process Electricity in the Electric System is Dependent Upon the Use of the Equipment to Produce a Finished Good.

Both parties agree that DTE begins industrial processing at the generator. Department's Brief at 5. The dispute in this case is the point at which the industrial processing of electricity ends because equipment used up to that point is exempt. The plain language of the Use Tax Act

defines when industrial processing ends. "Industrial processing . . . *ends when finished goods first come to rest in finished goods inventory storage.*" MCL 205.94*o*(7)(a)(emphasis added). Any questions about when industrial processing ends and the application of the exemption to service providers were laid to rest in 1999, when the industrial processing exemption was amended and expanded by the Michigan Legislature by adding a broad definition of "industrial processing." 1999 PA 117 included additional subsections that further expanded and enlarged the controlling definition of "industrial processing" to apply to specific users, specific activities and specific equipment and, for the first time, exempted equipment used to move product while in the process of production.[11] The detailed history of the industrial processing exemption up to 1999 contained within the Department's Brief is irrelevant to the issue at hand.

In enacting 1999 PA 117, the Legislature moved the industrial processing statutory provisions from subsection 94(g) to section 94*o*. 1999 PA 117 added, for the first time, a definition of "industrial processing,"[12] which was defined as:

> (a) "Industrial processing" *means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail* or for use in the manufacturing of a product to be ultimately sold at retail. . . . Industrial processing begins

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[11] 1999 PA 117.

[12] The version of "industrial processing" that existed prior to the 1999 Amendment was a one-section, two-subpart statute. App 350a. 1999 Public Act 117 expanded the exemption to multiple subsections. The prior definition in former MCL 205.94(g)(*i*) provided:

> "[i]ndustrial processor" means a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail.

This definition did not include additional activities or property that would qualify for the exemption, nor did it define when industrial processing ends. These provisions were added by 1999 PA 117.

> when tangible personal property begins movement from raw materials storage to begin industrial processing and *ends when finished goods first come to rest in finished goods inventory storage.* [MCL 205.94*o*(7)(a) as added by 1999 PA 117, emphasis added].

In addition to defining "industrial processing," 1999 PA 117 also included the following activities as constituting "industrial processing":

> (3) Industrial processing includes the following activities:
>
> (a) Production or assembly.
>
> * * *
>
> (d) *Inspection, quality control, or testing* to determine whether particular units of materials or products or processes conform to specified parameters at any time before materials or products first come to rest in finished goods inventory storage.
>
> (e) Planning, scheduling, supervision, or *control of production* or other exempt activities.
>
> (f) Design, construction, or *maintenance of production* or other exempt machinery, equipment, and tooling.
>
> [App 355a, emphasis added.]

1999 PA 117 also provided that in addition to property that performed specific functions, specific property is eligible for the industrial processing exemption:

> (4) Property that is eligible for an industrial processing exemption includes the following:
>
> * * *
>
> (f) Machinery, equipment, or materials used within a plant site or between plant sites operated by the same person *for movement of tangible personal property in the process of production. . . .* [*Id.*, emphasis added].

The industrial processing exemption applies to all equipment used in industrial processing activities, whether used by an industrial processor or by a service provider. *Granger Land Dev Co v Dep't of Treasury*, 286 Mich App 601; 780 NW2d 611 (2009). Thus, under

Granger, once DTE begins the industrial process of the production of electricity, all equipment used in the industrial process is exempt until a final product is achieved. As this Court has said, "to determine whether the industrial processing exemption applies, it is necessary to consider the activity in which the equipment is engaged and not the character of the equipment-owner's business." *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144, 157; 549 NW2d 837 (1996). As discussed further below, DTE personnel and the experts have provided uncontroverted evidence and testimony regarding the use, function and activities of the equipment. Because this equipment performs industrial processing activities as defined by the statute, the equipment qualifies for the exemption.

In 2004, the Legislature separately imposed tax on the transmission and distribution of electricity, i.e., it was to be taxed in the same manner that electricity (as a product) was taxed. See 2004 PA 172. This legislation was necessary to address the possibility that the state would lose the ability to tax the retail sale of electricity once electric deregulation was implemented. With deregulation (where the electricity and the transmission and distribution service would be "unbundled" and could be purchased from separate providers), the state would lack the ability to collect tax from the customer on the electricity charge if the seller lacked "nexus" with the state.[13] As noted by the Court of Appeals, 2004 PA 172 was not concerned with, nor did it have any applicability to, the definition of industrial processing involved in this matter. App 69a.

3. Qualification Under the Controlling Provision of the Industrial Processing Exemption of MCL 205.94*o*(7) is Permitted Until There is a Finished Good.

[13] Under deregulation, residents were able to purchase their electricity separately from the provider of transmission and distribution services. Pre-deregulation, the consumer would be liable for tax on the total cost. Thus, legislation was required to permit the Department to impose use tax on the customer for both charges, as tax would not be collected by an out-of-state seller.

The controlling definition of industrial processing requires that there be a "finished good" before industrial processing ends, and such "finished good" status requires that the product be in its final form, usable by, and ready for, sale to the customer. MCL 205.94*o*(7). Because electricity does not reach its final finished form, usable by the customer, until the customer's meter, all equipment used by DTE in the production of electricity in its Electric System prior to that point qualifies for exemption.[14] This Court has repeatedly held that machinery and equipment that processes a product to the final form sold to the customer is used in industrial processing. *Edison v Dep't of Revenue,* 362 Mich 158, 159; 106 NW2d 802 (1961) ("industrial processing requires preparing a product for sale to the consumer"); *Kress v Dep't of Revenue,* 322 Mich 590, 593; 34 NW2d 501 (1948) (holding that industrial processing means conditioning the product for later sale); *Bay Bottled Gas v Dep't of Revenue*, 344 Mich 326, 330; 74 NW2d 37 (1955) (industrial processing is processing for the market).

Thus, all of the equipment at issue is used by DTE in the production of electricity in its Electric System prior to the production of the "finished good" and is exempt under the industrial processing exemption. Professor Fuchs Aff ¶41, App 238a; Professor Wollenberg Aff ¶43, App 254a; Phillips Aff ¶116, App 215a. As substantiated by the comprehensive record, to which the Department has failed to provide a scintilla of evidence to the contrary, each of the three categories of equipment changes the composition, quality, combination or character of the electricity and thereby falls squarely within the controlling definition of industrial processing in MCL 205.94*o*(7)(a).

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[14] See, Professor Wollenberg Aff ¶36, App 253a; Professor Fuchs Aff ¶34-41, App 237a-238a; Phillips Aff ¶¶112-117, App 214a-215a. This is contrary to the Department's assertion that a furniture kit is not a finished good. With the sale of a furniture kit at retail, all processing has been completed, and it is the kit itself that is a finished good. Department's Brief p 23. The same analysis applies to the television example used by the Department.

Voltage Processing Equipment converts, conditions and changes the character of the electricity which is necessary to achieve the proper voltage of the electricity before it is a final retail product usable by customers. Phillips Aff ¶118, App 215a. For example, included in this category are transformers that change voltage and have long been exempted by the Department as industrial processing equipment. Attachment C to Phillips Aff App 54b; Department of Treasury Memorandum to the Deputy Treasurer and the Commissioner of Revenue, App 86b; Department of Treasury, Industrial Processing Training Manual, Part 1, App 179b-238b; Vettel Dep 11:6-8 (transformers routinely treated as exempt), App 15b.

Power Quality Control Equipment converts and conditions the electricity by changing the composition and quality of the electricity and aligning voltage. Phillips Aff ¶129-130, App 216a. For example, included in this category are capacitors that assist in aligning the voltage with the current. *Id.* at ¶130, App 216.

Safety and Power Monitoring Equipment controls, monitors and tests the electricity to ensure conformity with mandated MPSC specifications at any time up to, and through, the customer's meter. Phillips Aff ¶132, App 216a. For example, included in this category are temperature gauges and control meters. *Id.* at ¶133, App 217a.

Having met the controlling definitional standard for industrial processing, all of the equipment at issue is exempt.

4. The Equipment Qualifies Not Only Under the Controlling Definition of the Industrial Processing Exemption, But Also Qualifies Under The Specific Inclusions Contained Within the Exemption.

Not only do the activities of the equipment fall under the controlling definition of "industrial processing" but these activities performed by the equipment at issue have been specifically defined as industrial processing activities by the Legislature under subsections MCL

205.94*o*(3) and MCL 205.94*o*(4). When interpreting a definitional section of a statute that uses the word "include", it is an expansion of that definition, not a limitation. *NACG Leasing v Dep't of Treasury,* 495 Mich 26, 31; 843 NW2d 891 (2014) ("As we have stated previously, 'including' is a term of enlargement, not limitation."). Thus, providing specific subsections to further expand the controlling definition to specific types of activities, users, and property, requires the subsections to be treated as an expansion of the controlling definition contained within MCL 205.94*o*(7)(a). The equipment at issue is contained in the controlling definition of "industrial processing" activities, as well as contained in the specific definitions of quality control, testing, planning, production and conditioning activities that the Legislature further defined as qualifying as "industrial processing." The statute must be read as a whole to avoid error and to be harmonious with the intent of the Legislature as expressed in 1999 PA 117 to exempt such equipment.

Voltage Processing Equipment meets the definition of industrial processing contained in MCL 205.94*o*(7)(a), as well as the specific inclusion contained in MCL 205.94*o*(3)(d), as the equipment assists in the inspection, quality control and testing of the electricity to determine if the electricity conforms to MPSC requirements prior to the providing of the electricity to the customer.[15]

Power Quality Control Equipment controls the quality of the electricity and controls the production of the electricity to determine whether the electricity conforms to MPSC requirements regarding voltage. Phillips Aff ¶127, App 216a. Power Quality Control Equipment protects the Electric System from excessive voltage, and isolates abnormal

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[15] Examples of this equipment are arrestors, autoreclosers, bleeder devices, and capacitors. Attachment C to Phillips Affidavit App 46b-47b.

conditions.[16] Phillips Aff ¶127, App 216a. Power Quality Control Equipment meets the specific inclusion contained in MCL 205.94*o*(3)(e), as the equipment assists in the planning, scheduling, supervision and control of the production of electricity.

Lastly, Safety and Power Monitoring Equipment meets the specific inclusion contained in MCL 205.94*o*(3)(d), as the equipment assists in the inspection and testing of the production of electricity.[17] The Department's guidelines recognize that the safety and monitoring of a product such as electricity during production constitutes industrial processing. See Plaintiff's Brief in Support, Exhibit 28, Revenue Admin Bull 2000-4, Conclusion III, ¶4, p 4, App 93b,; Department of Treasury Industrial Processing Training Manual, Part 1, p 6, App 184b; ("inspection, supervision and maintenance of a durable good before it becomes a finished good are activities that constitute an industrial process"); *Detroit Edison,* 303 Mich App at 623. [App 8b]. All of these exempt activities occur prior to the electricity reaching its final form and are clearly subject to the industrial processing exemption.

When 1999 PA 117 was passed, the Department's contemporaneous interpretation of that statute confirmed the Department's acknowledgment that equipment used beyond the generation plant in transmission and distribution of the electricity, whether by the electricity generator or a service provider, until the electricity is in final form, was intended by the Legislature to be exempt. In a Department of Treasury Memorandum to the Deputy Treasurer and the

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[16] Examples of this equipment include arrestors, breakers, reclosers, fuses. Phillips Aff ¶¶128-131, App 216a; Attachment C to Phillips Aff, App 46b, 49b, 52b.

[17] Examples of this equipment include transformers, temperature gauges, relays, control meters. Phillips Aff ¶133, App 217a.

Commissioner of Revenue [App 86b][18] regarding the treatment of utilities companies under the expanded industrial processing statute, the Legal and Hearings Division explained that:

> Under the expanded industrial processing statute, as written today (after 1999 PA 117 was effective), utility companies will receive the *following expansive treatment.*
>
> 1. Deductibility of Transformers and Compressors. After electric utility deregulation is put into effect, the utility companies may no longer be electricity manufacturers. Accordingly, they will not constitute industrial processors because they will not be producing a taxable product – electricity. *Without the expanded statute, they would lose exemption for their transformers and partial exemptions for substations. Under the new legislation, the utility companies can be treated as servicers and will thus retain their exemptions.* [Emphasis added].

Thus, the Department has acknowledged that: (1) transformers and portions of substations were exempt under the prior law; and (2) under 1999 PA 117, these exemptions would be expanded, irrespective of the entity that initially generated the electricity. This is the correct application of the expanded exemption enacted by 1999 PA 117 to DTE's electricity operations, as contemporaneously acknowledged by the Department. (*Id.*, App 86b).[19]

5. The Department's Argument That Voltage Processing Equipment, Power Quality Control Equipment, and Safety and Power Monitoring Equipment Are Not Included in the Statutory Definition of Industrial Processing Because of the Carve-Out of MCL 205.94*o*(6)(b) for Shipping and Distribution Activities Is Incorrect.

The Department alleges that voltage processing, power quality control, and the safety and power monitoring activities performed by DTE's equipment (which are specifically included

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[18] Pursuant to *In re Complaint of Rovas Against SBC Mich*, 482 Mich 90; 754 NW2d 259 (2008), such interpretation is to be afforded respectful consideration.

[19] See also Revenue Admin Bull 2000-4; Michigan Department of Treasury Revenue, *Technical Tax Training, Sales and Use Tax: The Industrial Processing Exemption* (July 2002) App 111b; Michigan Department of Treasury Industrial Processing Training Manual Part 2, pp 11-12, 37 App 249b-250b, 275b.

within the controlling definition and the definitional extension subsections), are nonetheless removed from the exemption by the language of MCL 205.94*o*(6)(b), which carves out from the exemption specific, and limited, activities that do not qualify as "industrial processing," namely "sales, distribution, warehousing, shipping, or advertising activities." The Department's argument is clearly wrong for four reasons. First, the Department's argument violates the rules of statutory construction by failing to read the statute as a whole and to reconcile conflicting subsections. Second, certain distribution activities are specifically included in the industrial processing exemption. Third, classifying the equipment as "shipping and distribution" conflicts with the actual activities conducted by the equipment. Finally, exempt industrial processing activities that occur concurrently with nonexempt activities have long been acknowledged as exempt.

As discussed above, the activities of the equipment fall under the controlling definition of "industrial processing." In addition, the activities of the equipment also qualify under the Legislature's specific inclusions for activities and property that must be included within the controlling definition of industrial processing. Construing the statute as whole,[20] when the equipment qualifies under the specific inclusions expanding and enlarging the controlling definition, the inquiry is over. The Legislature has affirmatively expressed its intent that the equipment at issue is specifically included in the defined industrial processing exemption. This Court need not look to a specific carve-out.[21]

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[20] *Fradco Inc v Dep't of Treasury,* 495 Mich 104, 112; 845 NW2d 81 (2014).

[21] Had the Legislature wished to specifically carve out "transmission and distribution" of electricity it would have done so, as it did in MCL 205.94*o*(5)(a), which addresses equipment affixed to real estate. None of DTE's equipment falls into this category.

Nonetheless, the Department asks this Court to hold that the carve-out of certain shipping type activities (which only occur once when a product has reached its finished form) from the controlling definition, overrules not only the inclusion of the voltage processing, power quality control, and safety and monitoring activities from the controlling definition of industrial processing contained in MCL 205.94*o*(7), but also from the specific additional inclusions to the controlling definition for "production, inspection, quality control, testing," "planning and control" and "monitoring of production activities" contained in subsections MCL 205.94*o*(3), and MCL 205.94*o*(4). The Department is essentially contending that a modification to the controlling definition cancels out qualification under that definition. The Department argues that the specific inclusions of subsections MCL 205.94*o*(3), MCL 205.94*o*(4) and MCL 205.94*o*(7) are merely "general" inclusions that conflict with the specific carve-out of subsection MCL 205.94*o*(6), and that subsection MCL 205.94*o*(6) controls. This argument is contrary to the rules of statutory construction. This Court has held that when there is a claimed inconsistency between subsections of a statute, the Court must read the statute as a whole, and reconcile the conflicts.[22] *General Motors Corp v Erves*, 395 Mich 604; 236 NW2d 432 (1975); *In re Landaal*, 273 Mich 248; 262 NW 897 (1935). Sections of statutes on the same subject must be construed to give all sections effect. *Fradco*, supra at 115; *Guitar v Bieniek*, 402 Mich 152; 262 NW2d 9 (1978); *Roberts Tobacco Co v Dep't of Revenue*, 322 Mich 519; 34 NW2d 54 (1948).

The fact that the statute contains subsection MCL 205.94*o*(6) to illustrate the activities that do not qualify as industrial processing does not disqualify DTE's equipment from the controlling definition of "industrial processing" contained in subsection MCL 205.94*o*(7) or the

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[22] The Department citation to *People v McKinley*, 496 Mich. 410, 415; 852 NW2d 770 (2014), is inapposite because the Department argues that there is a conflict between definitional sections. Appellant's Brief at 30. Here, there is no such conflict.

specific activity inclusions of production, inspection, quality control, testing, planning and control or monitoring of production in MCL 205.94*o*(3)(a), (d), (e), and (f) or the specific inclusion of equipment used to move goods in-process of production in subsection MCL 205.94*o*(4)(f). These subsections can be reconciled by interpreting the "shipping" carve-out to apply only to activities that occur after the production of a "finished product." Under the rules of statutory construction as set forth by this Court, any movement of electricity occurring during the voltage processing, power quality control, and safety and monitoring activities performed by the equipment at issue while processing the electricity, qualifies as industrial processing until the electricity becomes a final, finished product at the customer's meter.

The Department's own guidance applies the "shipping" carve-out only to finished goods. See, for example, Revenue Administration Bulletin 2000-4, Example 24, where the Department concludes that racks used to move product still undergoing industrial processing, are exempt.[23] App 98b. Paramount to this example is that the product is still in process, and is not a finished good. Similarly, all of DTE's equipment is exempt. Only by applying the subsection MCL 205.94*o*(6) carve-out to post-production activities can the specific inclusions and carve-outs be reconciled and the statute harmonized and applied as a whole as required by the rules of statutory construction. Contrary to the Department's contention, there is no conflict that cannot be

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[23] Example 24 provides:

> Portable racks that are used in *shipping in-process* materials between plant sites operated by the same person are exempt. The racks may be used for shipment of in-process materials and placed on licensed highway vehicles to other plants of the same person; the racks would still be exempt under industrial processing. However, racks that are only used when attached to licensed highway vehicles are taxable because the racks are part of the vehicle and are excluded from the exemption. Revenue Admin Bull 2000-4. [Emphasis added].

reconciled between subsection MCL 205.94*o*(3), MCL 205.94*o*(4) and MCL 205.94*o*(7) and subsection MCL 205.94*o*(6). The Department's argument must fail. Moreover, the Department's argument that the specific carve-out controls over the controlling definition is inherently flawed because it fails to reconcile how the specific inclusion of power quality control, testing, monitoring, and production control activities can be trumped by the generic "shipping" carve-out.

Second, the industrial processing exemption includes certain types of shipping, distribution, and other movement of in process property. The plain language of MCL 205.94*o*(7)(a) defines "industrial processing" as beginning with the movement of tangible personal property from raw material storage. In *Granger, supra,* the Court of Appeals held that heavy equipment that physically transported and processed raw waste material was "clearly being used as part of the industrial processing of the waste." *Granger*, 266 Mich App at 614. MCL 205.94*o*(4)(f) applies the exemption to equipment "used within a plant site or between plant sites . . . for movement of tangible personal property in the process of production." Thus, MCL 205.94*o*(4)(f) specifically acknowledges that equipment performing movement of product in the process of production will qualify for exemption, as long as the product has not yet reached the stage of a finished good. Under these two subsections, all movement of in-process goods is exempt from raw materials storage through the production of the finished good. Reading the statutory scheme as a whole, the Legislature could not have intended the "shipping" carve-out to trump the controlling definition of "industrial processing" in MCL 205.94*o*(7), the specific activities of production, inspection, quality control, testing, or monitoring in MCL 205.94o(3)(a), (d), (e), and (f), or the specific inclusion for equipment that moves product while in-process of production in MCL 205.94*o*(4)(f). *See Fradco,* supra at 112 ("courts [must]

consider 'the plain meaning of the critical word or phrase as well as its placement and purpose in the statutory scheme.'")

Third, the Department has erroneously equated the words "distribution" and "shipping," words commonly used in the context of transport of finished durable goods, with "transmission and distribution" of electricity.[24] The Department alleges, without discussion of the equipment's activities or record evidence, that the activities performed by the equipment should be characterized, in part, as the "shipping and distribution" of electricity. The Department would have the analysis end there and conclude that DTE is therefore ineligible for the industrial processing exemption. *See* Department's Brief at 15-16. As used in MCL 205.94*o*(6), the term "distribution" refers to the distribution of a finished product. However, utilities use the term "distribution" as defined within their regulatory accounting framework.[25] This Court has made it plain that whether equipment qualifies for the industrial processing exemption is based upon the activities that the equipment performs and not the business of the taxpayer. *Elias Brothers*, 452 Mich at 157. The Department has pointed to no evidence in the record that identifies the activities of the equipment as "shipping." To the contrary, the record is replete with evidence of the equipment's industrial processing activities. Professor Fuchs Aff ¶41, App 238a; Professor Wollenberg Aff ¶¶36, 43, App 253a-254a; Brown Aff ¶¶37-38, 46, 63, App 226a, 227a, 229a; Professor Fuchs Supp Aff ¶18, App 242a. It is improper for the Department to ignore the industrial processing activities conducted by the equipment occurring within the Electric System and disallow an exemption based on the term "distribution." The "shipping" carve-out does not

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[24] *The American Heritage Dictionary,* Second College Edition, p. 1131 (1976) definition of "shipping" is "the act . . . of transporting goods" and does not use the word "transmit" as inferred in the Department's Brief p 15. [App 85b]

[25] See supra, p 6.

apply to DTE's equipment, nor trumps the controlling definition, or the specific inclusions deliberately added by the Legislature. DTE's equipment meets the statutory definition of industrial processing activity.

B. DTE Has Consistently Taken the Position That the Equipment Qualifies for 100% Exemption Due to the Concurrent Nature of the Industrial Processing Activity That the Equipment Performs 100% of the Time.

For the first time, the Department argues that even if DTE qualifies for the industrial processing exemption, it is not entitled to the exemption because it did not propose a reasonable method or formula for apportioning the exempt and nonexempt uses of the equipment. This argument has not been preserved, and even if preserved, it does not apply because DTE is entitled to a 100% apportioned exemption that does not require the Department's approval.

1. The Department Failed to Preserve This Issue for Appeal and Therefore, it Has Been Waived.

The Department has not raised this argument at any previous stage of this litigation, either before the Court of Claims or before the Court of Appeals. It appears as though the Department first contemplated this argument when seeking leave to appeal to this Court. *See* Department's Application for Leave to Appeal p 26. Because the Department failed to raise this issue below, it falls squarely into the category of unpreserved issues that are not available for appellate review.

It is settled law that an issue not raised before the trial court may not be raised for the first time on appeal. *See*, e.g., *Walters v Nadell*, 481 Mich 377, 387; 751 NW2d 431 (2008) ("[u]nder our jurisprudence, a litigant must preserve an issue for appellate review by raising it in the trial court.") "[F]ailure to timely raise an issue waives review of that issue on appeal." *Napier v Jacobs*, 429 Mich 222, 227; 414 NW2d 862 (1987); accord, *Three Lakes Ass'n v Whiting*, 75

Mich App 564, 581; 255 NW2d 686 (1977) ("Plaintiff may not shift ground on appeal and come up with new theories"). Moreover, when a party does not raise issues in the trial court, those issues "are not available to it on appeal." *Therrian v Gen Labs, Inc*, 372 Mich 487, 490, 127 NW2d 319 (1964).

There are no special circumstances that justify considering unpreserved issues in this case. This Court only deviates from the rule that a party must have first raised its appellate issues before the trial court "in the face of exceptional circumstances." *Booth Newspapers, Inc v Univ of Mich Bd of Regents*, 444 Mich 211, 234, n 23; 507 NW2d 422 (1993). Such exceptional circumstances have included the potential for a miscarriage of justice or the necessity to resolve an issue to quell confusion generated by the Court's earlier opinions. *Id.*

2. DTE is Entitled to 100% Apportionment as the Equipment is Always Engaged in Activities That Constitute Industrial Processing.

Even if preserved, less than 100% apportionment is not required as the equipment performs industrial processing activities continuously, at all times, up to the point of the customer's meter. The apportionment provision of the industrial processing exemption is contained within section MCL 205.94*o*(2) which provides:

> The property under subsection (1) is exempt only to the extent that the property is used for the exempt purpose stated in this section. The exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department.

The Department claims that DTE failed to propose any reasonable formula or method for apportionment and that the use of any such formula or method is contingent upon the Department's approval. Department's Brief at 36. These statements are patently incorrect.

Under the plain language of MCL 205.94*o*(2), DTE is entitled to an exemption as apportioned based upon "exempt use to total use." DTE's industrial processing activities are occurring 100% of the time. For example, DTE uses a capacitor for 10 hours. During that 10 hours, the capacitor performs an acknowledged industrial processing activity for 10 hours. Thus, DTE is entitled to a 100% exemption, as 10/10 = 100%. The Department has provided no evidence that industrial processing has ceased or is not being conducted. Nothing in the statute prohibits a 100% exemption.

3. A Concurrent Exempt Use is Entitled to a 100% Exemption Under the Plain Reading of MCL 205.94*o*(2).

Even a concurrent use gives rise to a 100% apportionment formula. The apportionment provision of MCL 205.94*o*(2) was enacted as part of 1999 PA 117. The Legislature clarified and expanded the industrial processing exemption while allowing the exemption to be apportioned between exempt and nonexempt use. Under the 1999 amendments, the plain language of the industrial processing exemption does not limit the exemption unless there is a time period during which the equipment is not engaged in an industrial processing activity. As DTE's equipment is used 100% of the time in industrial processing activities a 100% exemption is required under the plain language of the statute. There was no need for MCL 205.94*o* to address concurrent use at the time of its enactment, as there was existing case law that was consistent with the apportionment provision of MCL 205.94*o*(2). See *Mich Allied Dairy Ass'n v Auditor General*, 302 Mich 643; 5 NW2d 516 (1942); *Mich Milk Producers Ass'n v Dep't of Treasury*, 242 Mich App 486; 618 NW2d 917 (2000) ("concurrent taxable use with an exempt use does not remove the protection of exemption.") The Court of Appeals was bound to follow this Court's precedent and its own precedent regarding concurrent use. *Negri v Slotkin*, 397 Mich 105, 110; 244 NW2d 98 (1976).

The Department's own guidance apportions the exemption only for sequential exempt and nonexempt uses. In issuing Revenue Admin Bull 2000-4 to explain the newly expanded industrial processing exemption of 1999 PA 117, the Department provided numerous examples to clarify how the apportionment provision of MCL 205.94*o*(2) would be applied. In Example 1, the Department computed the percentage of time a forklift was used in moving in-process parts (an exempt use), in comparison to the percentage of time the forklift was used in shipping and receiving activities (once a finished good had been achieved) (a nonexempt use). In Example 2, the Department computed the percentage of time a forklift was used to move steel bolts from their casting site to a building for hardening (an exempt use), in comparison to the use of the forklift the rest of the time in non-industrial processing activities (a nonexempt use). Revenue Admin Bull 2000-4 p 3 App 92b. In these examples, the exempt use occurs at a separate and distinct time from the nonexempt activity. There is a concrete distinction between when the equipment is performing an exempt use and a nonexempt use. These examples only limit the exemption to less than 100% when the exempt use and the nonexempt use occur at different times. None of these examples limits the exemption when the exempt use occurs 100% of the time concurrently with a nonexempt use. There is nothing in the statute or the Revenue Admin Bull that prohibits the full exemption when the equipment is being used 100% of the time in an exempt use, albeit concurrent with a nonexempt use.

The Department has failed to rebut DTE's reasonable apportionment formula as supported by the expert testimony as to the function and use of the equipment and consistent with existing case law. The Department's argument fails to recognize that there are exempt processing activities and exempt movement of product in-process occurring simultaneously. Case law makes clear that the carve out for "shipping" activities of MCL 205.94*o*(6)(b) does not

swallow the statutory standard created by the controlling definition or the specific inclusions to that definition. *Kellogg Company v. Department of Treasury, Michigan State Board of Tax Appeals*, Docket No. 1037, April 28, 1977. So long as DTE's equipment is engaged in industrial processing, the exemption applies *even if* the equipment was also used simultaneously for a nonexempt activity.

4. Pre-approval to Apportion is Not Required from the Department.

No approval is required for DTE's 100% exemption because there is nothing to approve. The Department's own guidance does not require pre-approval to apportion 100% to exempt use. Revenue Admin Bull 2000-4 states:

> The formula or method used in determining the industrial processing exemption does not have to be pre-approved by the Department. However, the formula or method used does have to reasonably reflect the percentage of exempt use to total use. [App 91b (p 2)].

DTE has consistently maintained that its industrial processing equipment is fully exempt from use tax because it performs industrial processing activities 100% of the time that the equipment is in use. Any nonexempt activities that occur simultaneously or concurrently do not diminish the computation of the apportionment formula. DTE's apportioned exemption is supported by expert testimony that has proven by a preponderance of the evidence that the activities performed by the equipment occur prior to the electricity becoming a final product.[26] The use of an apportionment formula or method is not the same as the requirement to make an affirmative election. There is no form or guidance issued on how to obtain approval. Indeed, as

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[26] The Court of Appeals determined "the one expert relied on by the Department submitted an affidavit that is essentially conclusory in form. . ." *Detroit Edison,* 303 Mich App at 627. [App 106b.]

indicated in Revenue Admin Bull 2000-4, and as adopted by the Department in practice, pre-approval has not been required since the apportionment provision was enacted in 1999. As provided in Revenue Admin Bull 1989-34, "a Revenue Administrative Bulletin states the official position of the Department, has the status of precedent in the disposition of cases unless and until revoked or modified, ..." [App 88b.] The Department cannot now claim, for the first time, that DTE should be denied its exemption due to its failure to seek pre-approval.

C. Administrative Rules Must Yield When They Are in Conflict With the Statute

Administrative rules that conflict with the governing statute are invalid and unenforceable. *Insurance Institute of Michigan v Comm'r, Financial & Ins Services, Dep't of Labor and Economic Growth,* 486 Mich 370; 785 NW2d 67 (2010); *Guardian Industries Corp v Dep't of Treasury*, 243 Mich App 244, 254; 621 NW2d 450 (2000). When the Legislature enacted 1999 PA 117, the industrial processing exemption was specifically expanded to extend the industrial processing exemption to processing activities occurring from raw material handling to finished goods, to apply to service providers and to apply apportionment. The pre-existing rules of Rule 65 and Mich Admin Code, R 205.90(8) ("Rule 40(8)") are invalid because they do not reflect the amended law.

1. Rule 65 Was Rendered Invalid by the 1999 Statutory Amendments As Industrial Processing Continues Until There is a Finished Good.

In 1999, the Legislature expanded the Use Tax Act to more broadly exempt equipment used by an industrial processor, such as DTE, in performing industrial processing. The Department was aware of the impact this expanded exemption would have on producers of

electricity. See, *supra*, p 18 where the Department contemporaneously acknowledged that the treatment under 1999 PA 117 would be different from that afforded by Rule 65.[27]

The Department now asserts however, that except for DTE's activities at its generation plants, the only activities that DTE engages in within the Electric System are the "transmission and distribution" of electrical energy, which are activities that are taxable under Rule 65. This reliance on Rule 65 is unwarranted and violates sound rules of statutory construction. Rule 65, last amended in 1979, provides in relevant part:

> (3) The sale of tangible personal property is not taxable when consumed or used in the process of manufacturing or generating electricity, gas, or steam which is taxable when sold at retail. Transformers used in industrial processing are not taxable.
>
> (4) The sale of tangible personal property consumed or used in the transmission or distribution of electricity, gas, or steam is taxable. Such transmission or distribution starts at the place where the product leaves the immediate premises from which it is manufactured. [App 370a].

The conflict with the statute arises because the Rule 65 interpretation of the industrial processing exemption pre-dated 1999 PA 117.[28] In *Insurance Institute of Michigan, supra,* this Court reaffirmed the principle that an administrative rule cannot conflict with a statute when it invalidated an Office of Financial and Insurance Services promulgated rule that prohibited

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[27] The Department made no mention of Rule 65 in the Department of Treasury Interoffice Memorandum to Administrator Nancy Taylor, Deputy Treasurer and B.D. Copping, Commissioner, from June Summers Haas, Legal and Hearings Division, dated May 18, 1999, regarding the Treatment of Utilities Companies Under the Expanded Industrial Processing Statute. [App. 86b-87b].

[28] The Department recognized many of the rules promulgated in 1979 conflict with amended statutes. In the preamble to Michigan Department of Treasury, *General and Specific Sales and Use Tax Rules*, which includes Rule 40 and Rule 65, the Department states: "*Many of the rules are out of date and in need of revision.* Taxpayers should rely on these rules as they provide useful information for compliance with the law. However, *taxpayer's should consult the current statute for changes in the law subsequent to the issue date of the rule.*" [Emphasis added]. App 114b.

certain insurance pricing practices that the pertinent statutes allowed. That same principle applies herein, as Rule 65 would prohibit an exemption that the statute specifically grants.

To apply Rule 65 to today's statute improperly truncates the exemption by artificially declaring industrial processing over when electricity "leaves the immediate premises from which it is manufactured" without executing the statutory mandate to determine when there is a "finished good." Compare Rule 65(4) with MCL 205.94*o*(7)(a). In clearly defining when industrial processing ends, the statute makes the activities performed and the status of the product being processed the touchstone of the industrial processing definition. Even if there was some ambiguity (which there is not)[29] as to when electricity becomes a finished good under the statute, the Department's rule cannot supplant the statutory contours of the exemption. That analysis turns on the *nature* of DTE's activities, not where they occur. *See Elias Bros*, 452 Mich at 156 ("the application of the industrial processing exemption depends on the use to which equipment is put"). Rule 65 inverts the inquiry by focusing solely on location, ignoring the mandate of MCL 205.94*o*, and is thus invalid.

DTE established in the record that out-of-plant uses of its equipment involve industrial processing and that electricity is not a finished good until it reaches a customer's meter. The statute plainly includes DTE's activities in the definition of industrial processing without regard to their location, and the Court of Appeals properly concluded that electricity does not become a finished good until well *after* it leaves the "immediate premises" at which its manufacture began.

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[29] The Department argues that Rule 65 merely clears up ambiguity in the statute. Department's Brief at 29. However, the Department suggestion that electricity becomes a "finished good" when it leaves the generation plant, would cause Rule 65 to be internally inconsistent on its face, as Rule 65 specifically states that transformers used in industrial processing are not taxable. Rule 65(3). DTE's transformers are located throughout the Electric System. *See Detroit Edison*, 303 Mich App at 616, App 4b. The Department implicitly acknowledges that industrial processing can occur at transformers outside of DTE's plant, while at the same time claiming that electricity is a finished product as soon as it leaves the plant.

Detroit Edison, 303 Mich App at 628-629, App 11b. Since Rule 65 eschews all of this statutory analysis and makes the *location* of equipment and activities dispositive, it does not square with the contours of industrial processing as defined in the statute. The rule therefore conflicts with the statute and is invalid in this case.

The Department contends that the Court of Appeals labeled Rule 65 an interpretation of the statute rather than a binding administrative rule. Department's Brief at 25. Yet, the analytical distinction between an interpretive rule and a binding rule is irrelevant to this case. It is the Court, not any agency, that is ultimately charged with determining the "proper construction of the plain language of the statute." *In re Complaint of Rovas Against SBC Mich*, 482 Mich 90, 108. "[T]he agency's interpretation cannot conflict with the plain meaning of the statute." *Id.* Moreover, it does not matter whether an agency interpretation or construction at issue is contained in an interpretive rule or formalized in a binding administrative rule. *See Ins Institute of Mich*, 486 Mich at 385 (applying the standard of review to an administrative rule). The Department takes issue with the Court of Appeals label of "interpretive" to Rule 65 and the Department argues that, in *Discount Tire Co v Dep't of Treasury,* 494 Mich 875; 832 NW2d 391 (2013), this Court vacated a Court of Appeals opinion because it improperly treated a promulgated administrative rule as an interpretive rule. Appellant's Brief at 28. This is misleading. In *Discount Tire*, this Court vacated the lower court's opinion because it did not need to reach the issue of the rule's validity. 494 Mich at 875. The vacatur had nothing to do with whether the Court of Appeals' analysis of the validity issue was appropriate nor did this Court make any statement on the distinction between informal interpretations and binding rules. *Id.*

As interpreted and applied by the Department, Rule 65 conflicts with or modifies the plain language of section 94*o*, specifically the words and terms used by the Legislature in determining what qualifies as industrial processing. This superseded rule is in conflict with the statute and cannot be invoked to deny DTE's claim for exemption under the present facts. *Sington v Chrysler Corp*, 467 Mich 144, 155 n 9; 648 NW2d 624 (2002) (holding that case law that is inconsistent with a statute as amended must give way to the plain language of the statute). Had the Legislature desired to specifically exclude the "transmission and distribution" of electricity from the application of the industrial processing exemption, it could have expressly done so when it enacted 1999 PA 117. *Union Carbide Corp v Public Service Comm*, 431 Mich 135, 150 n 9; 428 NW2d 322 (1988). Contrary to the Department's conclusion, it is clear that the Legislature (being fully aware of Rule 65 as this rule pertained to industrial processing) chose to ignore the language of Rule 65 and to not make it a part of the Use Tax Act.

2. Subsection (8) of Rule 40 Upon Which the Department Relies Conflicts With the Statute and Therefore, is Invalid.

As discussed above, the statute does not require preapproval for 100% apportionment. The Department does not require preapproval for 100% apportionment. Rule 40(8) is invalid because it conflicts with the statute. Rule 40(8) provides:

> Where the industrial processing area or spaces are not separate and distinct from other departments or activities, or where the same tangible personal property can be used or consumed in the industrial processing area and 1 or more other areas, the tax will apply to such property unless it can be determined and substantiated to the satisfaction of the revenue division, department of treasury that a percentage or other apportionment thereof is equitable and practical. [App 373a-374a.]

The Legislation chose not to adopt Rule 40(8) in the 1999 Amendment. The Department argues that Rule 40(8) negates any exemption unless and until the Department agrees upon a

percentage for exemption.[30] Under the Department's interpretation, property used in exempt and nonexempt activities is entitled to a 0% exemption unless the Department determines otherwise. This is simply wrong. As discussed above, the statute requires that industrial processing equipment is entitled to an exemption to the extent of exempt use. See supra pp 25 to 28. Additionally, Rule 40(8) cannot be harmonized with 1999 PA 117. The statute only gives the Department the discretion to determine if an apportionment formula or method is reasonable. It does not give the Department the authority to deny any exemption when the equipment is used 100% of the time in an exempt activity, or continuously engaged in an industrial processing activity. Nor did 1999 PA 117 require a 0% exemption if any portion of the equipment's use was in a nonexempt activity.

Rule 40(8) is not simply filling a void in the statute, nor could it possibly do so. *See* Department's Brief at 38. The original version of 1999 HB 4744 as introduced, later enacted as 1999 PA 117, indicated an intent to include Rule 40 in full. App 299b-328b. However, this inclusion was later eliminated from the final version of 1999 HB 4744 that was adopted.[31] App 314b-331b. This failure to include Rule 40(8) in the final version evidences the Legislature's rejection of Rule 40(8). Because Rule 40(8) was promulgated before the 1999 Amendment, the rule is inherently untethered from the text of the statute.[32]

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[30] Contrary to the Department's assertion, it does not follow from Treasury's statutory authority to approve a formula that the taxpayer has an "obligation . . . to propose such [a] formula." Department's Brief at 37. The Department merely assumes that it is the taxpayer's burden to propose a formula in the first instance. Department's Brief at 33, 36.

[31] Comparing versions of a bill prior to final adoption has been held by this Court as indicative of legislative intent. See, e.g., *People v Gardner*, 482 Mich 41, 58 (2008).

[32] The substance of Rule 40(8) was first introduced in the 1944 Admin Code.

Because Rule 40(8) fails to reflect statutorily mandated apportionment that grants full or partial exemption, it is invalid.[33] Under the statute, the Department is to approve "a reasonable formula or method for determining the percentage of exempt use to total use." *Id.* But, Rule 40(8) makes no mention of a reasonable formula or method. Rather, it invokes an unrelated and arbitrary "equitable and practical" standard. Mich Admin Code R 40(8). The Department is attempting to persuade this Court that even if the equipment is exempt, and DTE is entitled to a 100% apportioned exemption, the Department has the authority to prohibit the exemption in full. This is not what the law provides.

D. Policy Considerations of Tax Pyramiding and Electric Affordability Support DTE's Harmonious Interpretation and Application of the Industrial Processing Exemption to Equipment Which Performs Industrial Processing Activities in the Electric System

1. This Court Has Expressed a Preference For the Avoidance of Tax Pyramiding.

The purpose of statutory construction is to read a statute as a whole to enforce the Legislative intent. This Court has interpreted the legislative purpose of the industrial processing statute to prevent tax pyramiding because it is against public interest and should be avoided. *Elias Bros,* 452 Mich at 152-153. When a manufacturer purchases equipment to produce a product for final sale at retail, if the equipment were subject to use tax and the final product were subject to sales tax, there would be an unlawful pyramiding of taxes. The industrial processing exemption exists in Michigan and many other states that impose sales and use taxes so as to prevent this pyramiding of taxes. As this Court has stated:

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[33] The two unpublished, nonprecedential cases cited by the Department on p. 38 of its Brief are inapposite. Both of those cases dealt with provisions of Rule 40 that had not been countermanded and changed by PA 117.

> *If the end product is taxed, the components used or consumed in its production are not taxed so that the product is not subject to double taxation . . ..*[*Id.,* emphasis added.]

As the sale of electricity is subject to sales or use tax,[34] and the price charged for the electricity reflects the costs incurred, to impose sales or use tax on the equipment used to process electricity into the final product sold to the customer would result in unlawful double taxation, or "pyramiding of tax." This Court has held that the policy behind the industrial processing exemption is to prevent "pyramiding of tax." *Elias Bros*, 452 Mich at 152. ("The Legislature also sought to avoid multiple layers of taxation—referred to as pyramiding—by exempting property used or consumed in the production of goods that will ultimately be subject to a use or sales tax when purchased by consumers; [a]ccordingly, the use tax does not apply to property sold to an "industrial processor for use or consumption in industrial processing.") See also *Granger Land Dev Co,* 286 Mich App at 608. Because DTE's electricity is subject to tax, the machinery and equipment used to prepare it for sale should not be.

Although the Department attempts to convince this Court to adopt a narrow interpretation of the industrial processing exemption, the Court of Appeals has held that when an exemption functions to avoid double taxation the restricted construction principle is not operative. In *City of Troy v Cleveland Pneumatic Tool Co,* 109 Mich App 361; 311 NW2d 782 (1981), the Court of Appeals held that the General Property Tax Act ("GPTA") inventory exemption (MCL 211.9c) is not subject to narrow construction against the taxpayer because the purpose of the exemption is to avoid double taxation of inventory beginning with the adoption of the Single Business Tax Act ("SBTA"), 1975 PA 228, MCL 208.1 et seq. (to extent inventory exemption functions to

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[34] MCL 205.51a

avoid double taxation between the GPTA and the SBTA, "restricted construction principle is not operative."). *Id.* at 371

2. This Case is of Limited Applicability and Directly Impacts Electric Affordability for Michigan Residents.

The Department raises the specter of a "massive loophole" if the decision of the Court of Appeals is not overturned. This is a red herring. This case is limited to the law of the industrial processing exemption applied to the specific equipment engaged in industrial processing during the distribution and transmission phases of providing electricity. There are few taxpayers in this class.

Of greater concern is the burden of double taxation and the need for electric affordability to the residents of the state. Affordability continues to be an issue for Michigan utilities and their customers. The Governor's Energy Task Force has been established with a goal to achieve "affordability" in regards to the following two objectives: (1) residential customers should spend less on their combined energy bills (electric and heat) than national averages, and (2) ensure energy-intensive industries can choose Michigan for investment and employment decisions, to better compete.[35] Should this Court overturn the Court of Appeals' Decision, all Michigan residents would bear the burden of double taxation as the result of tax pyramiding. In addition, all Michigan residents would experience a consequential increase in their electric rates, as use tax is a cost included in DTE's MPSC-approved rates charged to customers.[36] The customer affordability factor is critical to the state, and the effect of overruling the prior court's well-reasoned Decision, absent error, would harm those in the state least able to afford higher electric

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[35] See, State of Michigan Government Website, Governor Snyder's Energy Message (Posted December, 2013), http://michigan.gov/energy (accessed December, 2014.)

[36] Brown Aff ¶24, App 224a.

costs, and would create a clear double burden of tax with the potential of irrevocable harm to all Michigan residents.

V. CONCLUSION

The plain language of the industrial processing statute generally, and specifically, exempts the equipment used by DTE in providing electricity to its customers from use tax. A customer cannot plug directly into a generation plant to receive usable power. DTE is entitled to the exemption in full, as the equipment is performing exempt activities 100% of the time that it is in use, prior to the production of a finished good, which is delivered once electricity reaches the customer's meter in a form usable by the customer. The outdated rules cited by the Department in an attempt to deny the exemption are invalid, as they predate the existing statute and cannot be harmonized with existing law. The policy of avoidance of tax pyramiding, coupled with the policy of energy affordability, require that attempts to double tax must be avoided. The Department's assessment of use tax on DTE's equipment, which performs industrial processing activities, is unlawful, and this Court should affirm the Court of Appeals' Decision that DTE's equipment performs industrial processing activities and qualifies for a full exemption.

Respectfully submitted,

HONIGMAN MILLER SCHWARTZ AND COHN LLP

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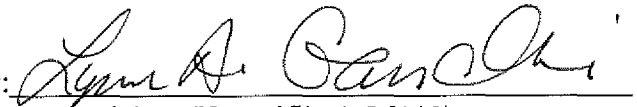
By: 

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